

# **Real Estate Withholding Law Changes**

## **Effective January 1, 2003**

### **1. What are the changes to real estate withholding?**

Assembly Bill 2065 (Chapter 02-488) revised Revenue and Taxation Code Section 18662 for sales of California real property that close on or after January 1, 2003. For sales closing before January 1, 2003, withholding is required when the seller is a nonresident or a corporation with no permanent place of business in California. The new law expands the withholding requirement to include resident individuals. In addition, the new law eliminates the waiver process for individuals, but provides more exemption possibilities.

### **2. What is real estate withholding?**

Real estate withholding is a prepayment of state income taxes for sellers of California real estate. California, like the federal government, has a “pay as you go” tax system, meaning taxes are due as you earn income, not after the end of the year when you file your state income tax return. Real estate withholding will, in many cases, save the seller from having to make estimate payments to cover the tax due on the gain on the real estate sale.

### **3. Who is subject to withholding?**

For sales closing on or after January 1, 2003, all individuals who sell California real property and do not qualify for an exemption are subject to withholding. All non-individual sellers with a last known street address outside of California who do not qualify for an exemption remain subject to withholding.

### **4. Who are individuals?**

Individuals are human beings as opposed to entities such as corporations, partnerships, estates, trusts, etc. Individuals also include husbands and wives who are on title together.

### **5. What are non-individuals?**

Non-individuals are any type of entity, other than individuals, such as corporations, estates, partnerships, trusts, etc. An exception is revocable (grantor) trusts. Revocable trusts are not considered to be entities for taxable purposes. Therefore, if the property is held in the name of a grantor trust, the seller is considered to be the grantor, who are frequently individuals.

**6. Is the trustee or the trust considered to be the seller?**

If the trust is irrevocable, then the trust is the seller and falls under the requirements for non-individuals. If the trust is revocable, then the seller is the grantor. Usually the grantor of a revocable trust is an individual and would fall under the requirement for individuals.

**7. What are the withholding exemptions for individual sellers?**

The exemptions for individuals are:

- Total sales price does not exceed \$100,000,
- Property is the seller's principal residence (IRC Section 121),
- Sales resulting in a loss for California tax purposes,
- Like-kind exchanges, with the exception of boot (IRC Section 1031),
- Involuntary conversions (IRC Section 1033), or
- Certain foreclosures.

Sellers meeting one of the above exemptions must sign a written certification under penalty of perjury (Form 593-C) to be exempt from withholding.

**8. What are the exemptions for non-individual sellers?**

The exemptions for non-individuals are:

- Corporations with a permanent place of business in California,
- Partnerships or LLCs,
- Tax exempt entities, insurance companies, IRAs, or qualified pension plans,
- Irrevocable trusts with a California trustee,
- Estates with a California decedent, or
- Banks or banks acting as a fiduciary for a trust.

Although the exemptions for non-individuals have not changed, sellers meeting one of the above exemptions must sign a different form (Form 593-W) to certify under penalty of perjury that they are exempt from withholding.

**9. Is there still a waiver process for individuals?**

No. For all real estate transactions closing on or after January 1, 2003, the waiver process is eliminated. However, many of the reasons for which waivers were previously granted are now certifiable exemptions.

**10. Can individual sellers who will have a small gain still apply for reduced withholding?**

No. The new law does not allow individuals to apply for reduced withholding for any real estate transaction closing on or after January 1, 2003. The full 3 1/3 percent of the total sales price must be withheld even though the sale will only result in a small gain.

**11. Must the full 3 1/3 percent of the total sales price be withheld on installment sales?**

Yes. Sellers of real property selling on the installment basis are subject to the full 3 1/3 percent withholding. However, withholding on the full sales price can be deferred if the buyer agrees to withhold 3 1/3 percent of the down payment and 3 1/3 percent of each payment thereafter. The buyer must complete and sign Form 593-I, Real Estate Withholding Installment Sales Agreement. This form must be attached to the Form 597 with the down payment withholding.

**12. How much should be withheld when there are multiple sellers?**

The total withholding is calculated on the total sale price and then allocated to each seller in proportion to their ownership interest.

*Example:*

|                     |           |
|---------------------|-----------|
| Total sale price    | \$200,000 |
| Withholding rate    | 3.33%     |
| Total withholding = | \$ 6,660  |

Sellers' share:

A = 20%, B = 30%, C = 50%

Withholding per seller:

|   |              |                    |
|---|--------------|--------------------|
| A | \$1,332      | \$6,660 x 20%      |
| B | 1,998        | 6,660 x 30%        |
| C | <u>3,330</u> | 6,660 x <u>50%</u> |
|   | \$6,660      | 100%               |

**13. How many Forms 597 should be filed when there is more than one seller (other than husband and wife)?**

A separate Form 597 must be filed for each seller. Each seller's Form 597 should include only the seller's proportional share of the withholding.

**14. How many Forms 597 should be filed when the sellers are husband and wife?**

Normally, just one Form 597 should be filed for a husband and wife. However, if the husband and wife are intending to file separate returns and wish to have the withholding applied to separate accounts, then a Form 597 should be filed for each spouse. Each spouse's Form 597 should include only the spouse's proportional share of the withholding.

**15. When sellers certify that they meet a withholding exemption, should the information be sent to FTB for review/approval?**

No. The withholding exemption certificate (Form 593-C for individuals or Form 593-W, Part I for non-individuals) should not be sent to FTB unless specifically requested by the FTB. The escrow office must keep these forms in their files.

**16. Is there still a waiver process for non-individuals?**

Yes. The law has not changed for non-individuals. However, requests for waivers or reduced withholding must be made using the new Form 593-W, Real Estate Withholding Exemption Certificate & Waiver Request for Non-Individual Sellers.

**17. Will the procedures change for paying and reporting the withholding?**

No. The basic procedures will not change for 2003. However, we are exploring ways to streamline the payment and reporting processes for 2004.

**18. Has the due date for Form 597 and payment of withholding changed?**

No. The due date is still the 20<sup>th</sup> day of the month following the month title is transferred.

**19. Will interest be assessed on late payments of withholding?**

Yes. The assessment of interest on late payments is mandatory. The imposition of interest is not a penalty, but compensation for the use of funds. Interest is computed from the due date of the withholding payment to the date payment is received.

**20. Who is responsible for withholding?**

The buyer or other transferee is responsible for withholding, completing Form 597, providing two copies of Form 597 to the seller, and providing one copy of Form 597 to the FTB along with the withholding payment by the due date. However, buyers normally delegate these responsibilities to the escrow company.

**21. What is the escrow company required to do?**

The escrow company is required to notify buyers in writing of their withholding obligation. When the escrow company has been directed to withhold by the buyer, or has assumed responsibility to withhold, the escrow company must withhold and complete Form 597, provide two copies of Form 597 to the seller, and provide one copy of Form 597 to the FTB along with the withholding payment by the due date.

**22. How will the new law impact intermediaries or accommodators in tax-deferred exchanges?**

The new law requires intermediaries or accommodators to withhold 3 1/3 percent on any cash or cash equivalent (boot) an individual receives or to withhold 3 1/3 percent of the total sale price if the exchange does not occur or does not meet the requirements of IRC Section 1031. There is no longer a minimum amount of boot that must be received before withholding is required on the boot.

The intermediary or accommodator will no longer need to sign Form 597-E since the law automatically requires the intermediary or accommodator to withhold. In addition, when FTB grants a waiver to non-individuals because they intend to treat the transfer as the first part of a non-simultaneous IRC Section 1031 exchange, FTB will only require 3 1/3 percent withholding on any boot. If the exchange does not occur or does not meet the requirements of IRC Section 1031, withholding will still be 3 1/3 percent of the total sale price.

**23. Will there be new forms?**

Yes. The proposed form numbers and titles are listed below.

For Individual Sellers:

Form 593-C, Real Estate Withholding Certificate for Individual Sellers. (Used to certify that the individual seller meets one of the allowed exemptions).

Form 593-I, Real Estate Withholding Installment Sales Agreement. (Used by buyers when the buyer agrees to withhold on each payment instead of on the full price at the time of sale).

Form 593-L, Real Estate Withholding – Computation of Gain or Loss. (Used by sellers to compute the gain or loss on the sale).

For Non-Individual Sellers:

Form FTB 593-W, Real Estate Withholding Exemption Certificate and Waiver Request for Non-Individual Sellers. (Used to certify that the non-individual seller meets one of the allowed exemptions).

**24. When will the new forms be available?**

We anticipate that Forms 593-C, 593-L, 593-I, and 597 (revision 2002) will be available on the Internet in early December. Go to [www.ftb.ca.gov/geninfo/nrw/forms.html](http://www.ftb.ca.gov/geninfo/nrw/forms.html) to get updated forms. Printed forms will be available in January 2003. Publication 1016, Real Estate Withholding Guidelines, should be updated and available in early January 2003.

**25. Can we use the old forms for sales closing on or after January 1, 2003?**

No. Forms 597-W, 597-E, and 597-I will not be accepted. Also, the 2002 revision of Form 597, Real Estate Withholding Tax Statement, must be used for payments made in 2003.

**26. What is the penalty for failing to withhold?**

The penalty is the greater of \$500 or 10 percent of the amount required to be withheld.

**27. What is the penalty if the escrow person fails to notify the buyer in writing of the withholding requirements?**

The penalty is the greater of \$500 or 10 percent of the amount required to be withheld.

**28. What is the penalty if the seller signs a false exemption certificate?**

If the seller knowingly executes a false exemption certificate, the penalty is the greater of \$1,000 or 20 percent of the amount required to be withheld.

**29. What is the penalty for failing to file a correct or timely Form 597 with the FTB?**

If a correct Form 597 is filed within 30 days after the due date, the penalty is \$15. If a correct Form 597 is filed 30 days or more after the due date or a correct Form 597 is never filed, the penalty is \$50. If the failure is due to intentional disregard of the requirements, then the amount is increased to the greater of \$100 or ten percent of the amount required to be reported. The penalty is for each Form 597 that is not filed correctly or timely.

**30. What is the penalty for failing to furnish a correct or timely Form 597 to the seller?**

The penalty for failing to provide sellers with their copies of Form 597 is \$50 if a correct Form 597 is not provided by the due date. If the failure is due to

intentional disregard of the requirements, then the amount is increased to the greater of \$100 or ten percent of the amount required to be reported. The penalty is for each Form 597 that is not furnished correctly or timely.

**31. Where can I get a copy of the new law?**

For information on Assembly Bill 2065, go to:  
<http://www.leginfo.ca.gov/bilinfo.html>

**32. How can we get more information?**

We will send updates via e-mail to the escrow associations and escrow offices that we have on file. We will also post updates to our website at:  
[www.ftb.ca.gov](http://www.ftb.ca.gov) . You may also call us toll free at 888-792-4900, or E-mail us at [nrws@ftb.ca.gov](mailto:nrws@ftb.ca.gov).